Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

RONALD MORAN CADILLAC, INC., PETITIONER

v.

UNITED STATES OF AMERICA,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether accrued interest on a promissory note, the deduction of which was deferred in earlier years under *26 U.S.C. §267(a)(2)* because the note was owed to a related party, may be deducted by an accrual basis taxpayer in the year in which the holder of the note sells the note to an unrelated party?

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Ronald Moran Cadillac, Inc. ("RMC") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Ninth Circuit Court of Appeals is reported at this time. App., *infra*, at pp. 1 to 14. The panel opinion of the Court of Appeals is officially reported at *68 F.3d 306*. The opinion of the United States District Court for the Central District of California is not reported. App., *infra*, at pp. 15 to 19.

JURISDICTION

The opinion of the Court of Appeals was entered on October 12, 2004. A petition for rehearing was filed on November 24, 2004. No request for an extension of time to file a petition for writ of certiorari was filed. The Court of Appeals entered its Order and Amended Opinion on December 16, 2004,denying the Petition for Rehearing. Jurisdiction is conferred upon this Court pursuant to *28 U.S.C. §1254(1)*.

STATUTORY PROVISIONS

This action concerns *26 U.S.C. §267(a)*. The section provides in pertinent part:

§ 267. Losses, expenses, and interest with respect to transactions between related taxpayers.

(a) In general

(1) Deduction for losses disallowed

No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

(2) Matching of deduction and payee income item in the case of expenses and interest

If--

(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person, and

(B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b),

then any deduction allowable under this chapter in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made (or, if later, as of the day on which it would be so allowable but for this

paragraph). For purposes of this paragraph, in the case of a personal service corporation (within the meaning of section 441(i)(2)), such corporation and any employee-owner (within the meaning of section 269A(b)(2), as modified by section 441(i)(2)) shall be treated as persons specified in subsection (b).

(b) Relationships

The persons referred to in subsection (a) are:

* * * *

(2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual . . . .

STATEMENT

The petitioner Ronald Moran Cadillac, Inc. ("RMC") filed a claim for refund seeking the refund of tax and interest for 1992. The claim was based upon the net operating loss carry back from 1994 to 1991, with the unused loss carried forward to 1992.

RMC and the IRS disputed the method for determining the amount of the interest deduction under *26 U.S.C. §267(a)*. The IRS argued that the accrued but unpaid interest originally owed by RMC to its sole shareholder, Caesar Wackeen ("CAESAR"), cannot be deducted until it was actually paid. RMC argued that the sale of the promissory note to an unrelated party in 1994 allowed RMC to deduct all accrued interest because it was no longer owed to a related party.

In the District Court, the parties filed cross motions for summary judgment. The District Court granted the government's motion holding the clear reading of *26 U.S.C. §267(a)* prohibited RMC's deduction of the accrued interest until paid.

An appeal was taken to the Court of Appeals for the Ninth Circuit. The Court of Appeals had jurisdiction pursuant to *28 U.S.C. §§158(d)* and *1291*. The Court of Appeals affirmed the District Court. Thereafter, RMC filed a Petition for Rehearing. The Court of Appeals issued an amended opinion and order correcting its prior opinion and denying the Petition for Rehearing.

REASONS FOR GRANTING THE PETITION

A. This Court Should Grant the Writ to Clarify the plain meaning of an Important Federal Tax Statute, *26 U.S.C. §267*.

26 U.S.C. §267 addresses the if and when a taxpayer is allowed a deduction for losses, expenses and interest where the deductions arise in transactions between "related" taxpayers, as defined in *26 U.S.C. §267(b)*. The intent of the statute is to prevent "tax avoidance" between "related" taxpayers. The statute requires the matching of deductions and income in cases where the parties are related but use different methods of accounting. The relevant language of the statute is as follows:

> (2) Matching of deduction and payee income item in the case of expenses and interest. If–
>
> > (A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person, and
> >
> > (B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b),
>
> then any deduction allowable under this chapter in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made (or, if later, as of the day on which it would be so allowable but for this paragraph).

The language of the statute is straightforward. A taxpayer, on the accrual method of accounting, who would be entitled to an income tax deduction for accrued (but unpaid) interest, may not claim such a

deduction if, at the close of taxpayer's tax year, the interest is owed to a "related" taxpayer and the related taxpayer is on a method of accounting, such as cash, which does not require the related taxpayer to include the accrued interest in income on their income tax return until the interest is actually paid. The deduction is deferred until the year in which the accrued interest is includible in income of the "related" taxpayer or until the close of the year when the parties are no longer related.

There is no dispute that, but for *26 U.S.C. §267(a)*, RMC would have been able to deduct the entire amount of the accrued (but unpaid) interest. There is, likewise, no dispute that the note was sold to Torrance Management Company ("TMC"), an unrelated third party, prior to December 31,1994. Similarly, if the original loan to RMC had been made by an unrelated party, RMC would have been able to deduct the entire amount of the accrued (but unpaid) interest. Likewise, if CAESAR had not sold the notes owed by RMC to an unrelated party, RMC would not have been able to deduct any of the accrued interest until that interest was paid to CAESAR and included in his taxable income. **But CAESAR did sell the notes to an unrelated party (TMC) and, as of December 31, 1994, the notes were held by that unrelated party.** The bar to deduction of accrued (but unpaid) interest in *26 U.S.C. §267(a)* applies only where the parties to the note are "related" as of the last day of RMC's taxable year (in this case December 31, 1994). Under the literal language of *26 U.S.C. §267(a)*, RMC is entitled to deduct on its 1994 income tax return the entire amount of interest which accrued under the note, interest that

is unquestionably deductible in the absence of *26 U.S.C. §267.*

"[W]here . . . the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S.Ct. 1026, 1030 (1989),* quoting *Caminetti v. U.S., 242 U.S. 470 (1917).* "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafter.' In such cases, the intention of the drafters, rather than the strict language controls." *Ron Pair at 1031* quoting *Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 102 S.Ct. 3245, 3250 (1982).*

Even in the face of arguably compelling policy justifying a different result, the plan meaning of a statute is to be followed. *Patterson v. Shumate, 504 U.S. 753, 112 S.Ct. 2242, 2246 (1992).* Even if congress may not have foreseen all of the consequences it is not sufficient reason to refuse to give effect to the plain meaning of the statute. *Union Bank v. Wolas, 502 U.S. 151, 112 S.Ct. 527 (1991).*

The statute, *26 U.S.C. §267(a),* by its clear language, does not apply if the creditor and debtor are unrelated at the end of the year. The statute only applies if the parties are related. As of December 31, 1994, RMC and TMC were unrelated. All the accrued interest, as of December 31, 1994, was owed by RMC to TMC, an unrelated party. The clear language of the statute indicates that all accruals of interest are deductible by RMC in the year the note is sold or in the

year RMC and the party to whom payment is to be made are not persons specified in *26 U.S.C. §267(b)*. The "amount would be deductible" and is "allowable but for this paragraph" in 1994. The accrued interest is deductible by RMC in 1994 because it is no longer disallowed by *26 U.S.C. §267(a)(2)*. It is deductible as of December 31, 1994 because it is "allowable but for this paragraph." *26 U.S.C. §267(a)(2)*. The sale of the note to TMC created a new obligation and a new debtor/creditor relationship not affected by *26 U.S.C. §267*. As of the date of the sale of the note, the prior accrued interest becomes a new liability and a new accrual of all interest to TMC, not CAESAR.

B. The Ninth Circuit Opinion is Inconsistent with the Clear Meaning of the Statute.

The Ninth Circuit's interpretation of the statute is inconsistent with its clear language and Congressional intent. Congress amended the statute in 1984 changing the prior rule that disallowed any deduction if the amounts were not paid and the parties were related. The amendment allows prior accruals if amounts are paid (the parties remain related) or if the parties are unrelated and the amount is "so allowable but for this paragraph."

The parties and the courts below agreed that the congressional intent, and policy, was to prevent tax avoidance between related parties, through the use of differing accounting methods. See, *Metzger v. Commissioner, 76 T.C. 42, 75 (1981); H.R. No. 1546, 75 Cong. 1st Sess. (1937)*. The lower courts, though, ignore the amendment to *26 U.S.C. §267(a)* in 1984 and

Congress' intent to change prior law. Congress clearly intended to prevent the harshness of disallowing the deduction if the amount was not paid within 2½ months of the close of the year and if the parties were still related within 2½ months of the end of the year. See, *H.R. Rept. No. 432 (Part 2), 98th Cong. 2nd Sess. 1759 (1984)* and *S. Rept. No. 169, 98th Cong., 2nd Sess. 495 (1984)*.The policy and intent is not applicable because TMC and RMC are unrelated parties. As conceded by the government, below, the statute applies only to "a creditor with whom [the taxpayer] enjoyed a special relationship." Absent the special relationship there can be no tax avoidance between related parties. RMC's interpretation of the clear meaning of the statute is consistent with the Congressional intent. The Ninth Circuit's holding and interpretation is inconsistent with the clear Congressional intent to prevent tax avoidance between related parties.

RMC's interpretation of the statute is consistent with its clear meaning and Congressional intent. The deduction of all accrued interest is consistent with the statute because RMC and TMC were unrelated at the end of 1994. Likewise, there is no potential "tax avoidance between related parties" because RMC and TMC are unrelated. What Congressional intent will be furthered by denying the deduction? The interpretation by the District Court nullifies Congressional intent.

26 U.S.C. §267 does not preclude the deduction and does not require payment under these circumstances. As of December 31, 1994, there is nothing preventing the deduction of all of the accrued interest. As an accrual basis taxpayer, RMC can deduct all of the accrued interest to TMC, which became a new

obligation and new accrual as of September 24, 1994. The deferral provisions of *26 U.S.C. §267(a)* never applied to TMC and RMC. In the present case, the language of the statute is quite clear. The bar against deducting accrued interest on a note in *26 U.S.C. § 267(a)* does not apply where, as is the case here, the obligor of the notes and the holder of the notes are not "related parties" as of the end of the obligor's tax year.

The IRS has effectively acknowledged that the bar of *26 U.S.C §267(a)* does not apply in 1994. The IRS allowed the accruals of interest owed by RMC to CAESAR from January 1, 1994 to September 24, 1994, the date the note was sold. The IRS agrees the sale of the note to TMC makes *26 U.S.C. §267(a)* inapplicable even though RMC and CAESAR are related persons at the close of the year and even though the amounts have not been paid. (The lower courts agreed with the IRS that these amounts are deductible regardless of whether or not paid but concluded the allowance was not inconsistent with the disallowance of the prior accruals. If the sale of the note does not remove the application of *26 U.S.C. §267(a)* for <u>all</u> prior accruals, then the IRS would not have allowed the accruals from RMC to CAESAR for the period from January 1, 1994 to September 24, 1994, when the note was sold to TMC.) All of the interest accruals are fully deductible by RMC in 1994 and *26 U.S.C. §267(a)* does not apply because the interest is accrued and payable to TMC, a new unrelated creditor. It is not because RMC and CAESAR became unrelated, because they did not, but because of the <u>new</u> liability owed to TMC, an unrelated creditor, by RMC.

There is no support for the conclusion that *26 U.S.C. §267(a)* applies on a "year by year basis" and the clear language of the statute does not support such a conclusion. The statute clearly states "at the close of the taxable year" and not "at the close of each taxable year until the amounts are paid."

The Ninth Circuit's position is inconsistent with both the purpose of the statute and with the IRS's own application of the law. The purpose of the statute is to prevent manipulation of the tax code and tax avoidance due to differing accounting methods by related parties. If the ownership of the note is no longer in the hands of a related party, the potential for abuse dissipates. There is no logical reason to deny RMC a deduction for the entire amount of the accrued interest in the year in which the note was transferred to an independent third party when RMC would have been entitled to a deduction for the entire amount of the interest if the note had been held by an unrelated third party since the inception of the note.

The Ninth Circuit concedes that RMC is entitled to a deduction for the interest which accrued during 1994 because the "taint" of having related parties no longer exists as of December 31, 1994. This concession illustrates the lack of merit in the Ninth Circuit's position and its holding. If a deduction for the interest that accrued during 1994 is permissible because the taint of related parties had disappeared as of December 31, 1994, there is no logical basis for denying a deduction for the interest that accrued prior to 1994. The purpose of *26 U.S.C. §267(a)* was fulfilled by preventing RMC from deducting the accrued interest in those years in which the payor (RMC) and payee

(CAESAR) of the note were related parties as of the close of the taxable year of RMC. The purpose is not fulfilled by preventing RMC from deducting the full amount of the previously accrued interest in the year in which the ownership of the note was transferred to an unrelated third party. This is particularly so where the IRS concedes that RMC is entitled to a deduction for the interest that accrued in 1994.

CONCLUSION

Based on the foregoing, Petitioner Ronald Moran Cadillac, Inc. prays that this Court grant a writ of certiorari to review the decision of the Court of Appeals for the Ninth Circuit.

DATED: March 14, 2005 Respectfully submitted,

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No. 02-57052

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RONALD MORAN CADILLAC, INC.,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

March 3, 2004, Argued and Submitted, Pasadena, California

October 12, 2004, Filed

COUNSEL: A. Lavar Taylor, Law Office of A. Lavar Taylor, James M. Kamman (briefed), Law Office of James M. Kamman, Santa Ana, California, for appellant.

Francesca Ugolini, Department of Justice, Tax Division, Washington, D.C., for appellee.

JUDGES: Before: John T. Noonan and Andrew J. Kleinfeld, Circuit Judges, and Jeffrey S. White, * District Judge. Opinion by Judge White.

OPINIONBY: Jeffrey S. White

OPINION: AMENDED OPINION

WHITE, District Judge:

Ronald Moran Cadillac ("RMC") filed a claim for refund of income taxes for the year 1992 with the Internal Revenue Service ("IRS") pursuant to 26 U.S.C. § 7422 (hereinafter "I.R.C."). Six months passed without the IRS acting upon the refund claims; RMC then filed a complaint in the United States District Court for the Central District of California. The district court granted the government's cross-motion for summary judgment and entered judgment finding that RMC was entitled only to the refund that the government conceded was due for taxable year 1992. RMC timely appealed. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we affirm.

Facts

The facts of this case are not in dispute. Appellant RMC is the holder of a Cadillac franchise from General Motors Corporation. RMC is an accrual-basis taxpayer. n1 All of Appellant's stock is owned by Caesar Wackeen ("Caesar"), the president of Ronald Moran Cadillac. Caesar is a cash-basis tax-payer. n2 Prior to 1994, Caesar loaned and advanced to RMC a total of $ 2,339,929. The loans and accrued interest were memorialized in a written consolidation note dated January 1, 1994. RMC recorded all previously accrued interest due on the note, but did not pay any such interest to Caesar. In addition, RMC did not deduct the unpaid interest on its tax return because it was barred from doing so pursuant to I.R.C. § 267(a)(2), which governs the timing of interest deductions when the

interest is owed to a related taxpayer with a different accounting method.

On September 20, 1994, Caesar assigned his interest in the note, with all accrued, but unpaid interest owed, at a loss to Torrence Management Company ("TMC"). TMC is not related to either RMC or Caesar as defined in I.R.C. § 267(b). On his 1994 individual income tax return Caesar reported a capital loss of $ 500,000 based on the assignment of the note. RMC filed its 1994 tax return and reported a deduction totaling $ 1,049,657, representing all of the accrued, but unpaid, interest on the note that Caesar sold to TMC. Based on the claimed deduction, RMC alleged that it incurred a net operating loss ("NOL") of $ 810,0267 in 1994. RMC sought to carry back the entire 1994 NOL to 1991 and 1992.

Following consideration of RMC's 1994 tax return, the IRS determined that only the portion of accrued interest attributable to 1994 (*i.e.*, $ 261,663) was allowable as a deduction because RMC was not subject to the restrictions of I.R.C. § 267(a)(2) for 1994. Accordingly, the IRS disallowed RMC's deduction of $ 787,994 -- the interest accrued in the years before 1994. Based on this determination, RMC did not have a NOL carry back to offset its 1992 tax liabilities. n3 RMC filed a claim for refund with the IRS, asserting an entitlement to the entire interest deduction in 1994, which would result in an overpayment of 1992 income taxes in the amount of $ 47,993.

RMC raised two issues before the district court: (1) that the entire amount of the accrued interest up to 1994 (*i.e.*, $ 1,049,657) should be allowed as a deduction, and the NOL of $ 810,267 in 1994 should carry back to its

1992 tax liabilities ("the 1994 carry back claim"); and (2) that RMC is entitled to a refund of the 1992 taxes and interest based on a carry back of a NOL of $ 681,834 from 1995 ("the 1995 carry back claim"). The government conceded the merits of the 1995 carry back claim and represented that the IRS had credited the 1995 NOL to offset RMC's 1992 liabilities and abated all remaining interest accruals and penalties for 1992. The district court therefore only addressed the first claim for relief. n4 Following cross-motions for summary judgment, the district court granted the government's motion and found RMC's interpretation of I.R.C. § 267(a)(2) unsupported by a plain reading of the statute, the treasury regulation, and congressional intent. RMC timely appealed the court's finding that it is not entitled to a 1994 NOL carry back under I.R.C. § 267(a)(2).

Discussion

I. Standard of Review

This Court reviews de novo the district court's interpretation of the Internal Revenue Code and corresponding treasury regulations. Boeing Co. v. United States, 258 F.3d 958, 962 (9th Cir. 2001).

II. Background

As a general rule, I.R.C. § 163(a) allows a deduction for interest that is either paid or accrued during a taxable year. Metzger v. Commissioner, 76 T.C. 42, 74 (1981). Thus, an accrual-basis taxpayer may deduct interest that properly accrues during the taxable year, even if the interest is not actually paid during that year. I.R.C. § 461(a) & (h); *see also* Treas. Reg. § 1.461-1(a)(2). A

cash-basis taxpayer may deduct interest only when it is paid. Treas. Reg. § 1.461-1(a)(1). A cash-basis taxpayer may also include interest payments as income in the taxable year in which the payments are actually or constructively received. Treas. Reg. § 1.446-1(c)(1)(i). Therefore, if an accrual-basis taxpayer owes interest payments to a cash-basis taxpayer, the accrual-basis tax-payer may deduct the interest owed as it accrues, even if not paid, but the cash-basis taxpayer will not have to report the interest income until the interest is actually paid.

Given this statutory framework, Congress has enacted certain limitations to the general rule of I.R.C. § 163 to protect against sham transactions and manipulations without economic substance. One such limitation is set forth in I.R.C. § 267. *See* Metzger, 76 T.C. at 75 (stating that Congress enacted the predecessor of I.R.C. § 267 "to prevent the use of differing methods of reporting income for Federal income tax purposes in order to obtain artificial deductions for interest and business expenses.").

Amended in 1984, I.R.C. § 267(a)(2) provides for a matching of interest deductions and income where, in the case of related persons, the payor is an accrual-basis taxpayer and the payee is on a cash method of accounting. The purpose of the 1984 amendment was to require related persons to "use the same accounting method with respect to transactions between themselves in order to prevent the allowance of a deduction without the corresponding inclusion of income." H.R. Rep. No. 98-432, pt. 2 at 1579, 98th Cong. 2nd Sess. (1984). n5

III. I.R.C. § 267

A. Plain Meaning of I.R.C. § 267

I.R.C. § 267(a)(1) provides that "no deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly between persons" in certain relationships. These relationships include, among others, family members, two corporations that are members of the same controlled group, the grantors or beneficiaries of a trust and its fiduciaries, and individuals and the corporations they control. I.R.C. § 267(b) . Caesar is the sole shareholder of RMC, and the parties agree that RMC and Caesar are related parties as defined in I.R.C. § 267(b). The parties additionally agree that RMC fell under the restrictions of I.R.C. § 267 during the life of the note prior to 1994. The dispute arises over the continuing applicability of that restriction imposed in prior years once the creditor and debtor are no longer related parties.

Appellant contends that as of the end of taxable year 1994, RMC (the debtor) and TMC (the new creditor) were unrelated parties as contemplated by I.R.C. § 267(b) and thus, all of the accrued interest on the note (including interest accrued prior to 1994), was deductible by RMC in the year that TMC acquired the note. Appellee counters that under the plain language of the statute, the interest deductions that RMC could have claimed but for I.R.C. § 267 are allowable only when the interest is includible in the gross income of TMC. Essentially, the government contends that once I.R.C. § 267 is applicable to a particular tax year, it continues thereafter to apply to that tax year and is not retroactively eliminated because the creditor/debtor

relationship no longer triggers I.R.C. § 267.

The district court relied upon the statutory text of I.R.C. § 267(a)(2), supported by Temporary Treasury Regulation § 1.267-a2T(b) Question 5 , n6 and agreed with the government's interpretation of I.R.C. § 267. The court reasoned that the applicability of I.R.C. § 267 is determined "at the close of the taxable year of the taxpayer," *see* I.R.C. § 267(a)(2), and that once I.R.C. § 267 applies to a given taxable year, the tax-payer is barred from deducting interest expenses until "the day as of which such amount is includible in the gross income of the person to whom the payment is made." *Id.* This interpretation is correct.

The decision is controlled by well-settled principles underlying the federal tax system. First, "'each taxable year' must be treated as a separate unit, and all items of gross income and deduction must be reflected in terms of their posture at the close of such year." United States v. Consol. Edison Co. of New York, 366 U.S. 380, 384, 6 L. Ed. 2d 356, 81 S. Ct. 1326 (1961); *see also* I.R.C. § 461. This principle is reflected in the plain language of I.R.C. § 267(a)(2), which dictates that the applicability the section is made "at the close of the taxable year of the taxpayer." Application of I.R.C. § 267 on a year-by-year basis is consistent with the concept of annual accounting and the plain language of the statute. RMC does not point to any authority that suggests otherwise.

Second, deferred interest deductions do not amass over the years until the bar of I.R.C. § 267 is lifted resulting in the immediate deduction of the lump sum of interest accrued over multiple years. "The expenses, liabilities, or loss of one year generally cannot be used to reduce

the income of a subsequent year. A taxpayer may not take into account in a return for subsequent taxable years liabilities that, under the taxpayer's method of accounting, should have been taken into account in a prior taxable year." Treas. Reg. § 1.461-1(a)(3). Rather, in the event that a taxpayer discovers overlooked liabilities for a prior year, the appropriate method to claim these deductions is to file a timely claim for credit or refund. *Id.* Of course, this does not mean that RMC may never take the interest deduction; only that it must abide by the mandate of I.R.C. § 267(a)(2) and wait until "the day as of which such amount is includible in the gross income of the person to whom the payment is made." I.R.C. § 267(a)(2); *see also* Treas. Reg. § 1.461-1(a)(2)(iii) (specifically referring to, among others, I.R.C. § 267 and recognizing that certain code provisions may require liabilities to be taken into account in a later taxable year).

Application of these principles in conjunction with the plain language of I.R.C. § 267 supports the district court's ruling.

B. On-Going Effect of Restrictions stated in I.R.C. § 267

RMC contends that the IRS has taken inconsistent stances regarding the applicability of I.R.C. § 267, and in doing so effectively supports the position advanced by RMC. However, the IRS's determination that RMC may take a deduction of interest accrued, but unpaid, during the 1994 taxable year is supported by the plain language of the statute. "At the close of the taxable year of the taxpayer," *i.e.*, on December 31, 2004, the debtor (RMC) and the creditor (TMC) were not related.

See I.R.C. § 267(a)(2). Accordingly, in 1994 the parties' relationship did not trigger I.R.C. § 267. The fact that RMC and Caesar continue to be related parties at the end of 1994 has no impact on this determination because Caesar sold the note prior to the end of the 1994 taxable year. It is the relationship of the debtor and the new creditor that controls the analysis, and not the creation of a new liability.

RMC additionally contends that the sale of the note to TMC converts the prior accrued interest into a different liability and a different accrual of all of the interest to TMC. This assertion ignores the fact that Caesar merely assigned his interest in the note and reported the transaction as generating a $ 500,000 capital loss on his individual income tax return. Nevertheless, even assuming the validity of the argument, RMC still may not deduct the prior accrued interest in 1994. Pursuant to the plain language of I.R.C. § 267, an accrual-basis taxpayer is converted to a cash accounting method with respect to deductions of interest owed to a related cash-basis taxpayer. Under the cash accounting method, the taxpayer may deduct interest only when it is paid. Treas. Reg. § 1.461-1(a)(1). In other words, once it is determined that the restrictions of I.R.C. § 267 apply to accrued interest, those restrictions stay in effect until the interest is actually paid. The limitations enacted by Congress in I.R.C. § 267(a) to prevent tax avoidance would not be met if the tax deductions previously disallowed could be accelerated and then taken merely upon the sale of a note, but before payment of any outstanding interest The parties agree in their joint statement of uncontroverted facts that RMC had accrued, but had not deducted, the unpaid interest on the notes for the

periods prior to the sale of the note to TMC and did not pay these amounts prior to December 31, 1994.

C. Legislative History

Finally, the conclusion that we reach today is directed by the text of I.R.C § 267; accordingly, we need not assess the underlying legislative history. *See* Ratzlaf v. United States, 510 U.S. 135, 147-48, 126 L. Ed. 2d 615, 114 S. Ct. 655 (1994) ("We do not resort to legislative history to cloud a statutory text that is clear").

Conclusion

For the foregoing reasons, we affirm the district court's grant of summary judgment in favor of the government.

AFFIRMED.

---------- Footnotes ----------

* The Honorable Jeffrey S. White, United States District Judge for the Northern District of California, sitting by designation.

n1 An accrual-basis taxpayer deducts an expense when the liability is accrued. 26 U.S.C. § 461.

n2 A cash-basis taxpayer deducts interest in the year it is paid. Treas. Reg. § 1.461-1(a)(1).

n3 When the IRS allowed RMC the interest deduction of $ 261,663 for the year ending in 1994, it resulted in a NOL of $ 22,273 for 1994. The IRS allowed the $ 22,273

NOL as a carry back to 1991; however, this exhausted the available NOL from 1994 and resulted in no available NOL from 1994 to be carried back to 1992.

n4 The district court rejected the government's argument that resolution of the 1995 carry back claim rendered the 1994 carry back claim moot. The court found that a successful result for RMC on the 1994 carry back claim would afford it a greater refund in comparison to the 1995 carry back claim and additionally would avoid "failure to pay penalties" assessed under I.R.C. § 6651(a)(3), which still existed despite a favorable resolution on the 1995 carry back claim. The government does not challenge this ruling on appeal.

n5 In fact, the Ways and Means Committee had in mind a situation similar to that present in this case when it enacted the 1984 amendment: "The failure to use the same accounting method with respect to one transaction involves unwarranted tax benefits, especially where payments are delayed for a long period of time, and in fact may never be paid." *Id.*

n6 Question 5 states: "If a deduction in respect of an otherwise deductible amount is deferred by section 267(a)(2) and, prior to the time the amount is includible in the gross income of the person to whom payment is to be made, such person and the payor taxpayer cease to be persons specified in any of the paragraphs of section 267(b) (as modified by section 267(e)), is the deduction allowable as of the day on which the relationship ceases?"

Answer 5: "No. The deduction is not allowable until the day as of which the amount is includible in the gross income of the person to whom payment of the amount is made, even though the relationship ceases to exist at an earlier time."

RMC challenges the district court's discussion of this Temporary Regulation as irrelevant to the situation presented by this case, or in the alternative as invalid because the regulation is merely temporary and conflicts with the statutory language. The Temporary Regulation was neither central to the district court's analysis nor necessary for resolution of this case; a plain reading of I.R.C. § 267 set in the context of the statutory framework of the Internal Revenue Code resolves the issue before the Court without necessitating reliance upon the Temporary Regulation. Accordingly, this Court need not address RMC's arguments.

No. 02-57052

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RONALD MORAN CADILLAC, INC.,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

12/16/04

JUDGES: Before: John T. Noonan and Andrew J. Kleinfeld, Circuit Judges, and Jeffrey S. White, * District Judge.

OPINION: ORDER

The Opinion filed October 12, 2004, slip op. 14491, is amended as follows:1. At slip op. 14502, in the last sentence before sub-section C, change "RMC concedes that it has yet to pay any of the pre-1994 interest to either Caesar or TMC." to "The parties agree in their joint statement of uncontroverted facts that RMC had accrued, but had not deducted, the unpaid interest on the notes for the periods prior to the sale of the note to TMC and did not pay these amounts prior to December 31, 1994."

With this amendment, the panel has voted to deny the petition for rehearing. The petition for rehearing is DENIED.

No future petitions for panel or en banc rehearing will be entertained.

Footnote

* The Honorable Jeffrey S. White, United States District Judge for the Northern District of California, sitting by designation.

Case No. SACV 01-752 GLT(MLGx)

UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION

RONALD MORAN CADILLAC, INC.,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

September 20, 2002, Decided
August 30, 2002, Lodged; September 23, 2002, Filed; September 24, 2002, Entered; September 24, 2002, Enter on ICMS

COUNSEL: For RONALD MORAN CADILLAC INC, plaintiff: James M Kamman, James M Kamman Law Offices, Santa Ana, CA.

For UNITED STATES OF AMERICA, defendant: Assistant US Attorney, AUSA - Office of US Attorney, Los Angeles, CA. Sandra R Brown, AUSA - Office of US Attorney, Los Angeles, CA.

JUDGES: GARY A. TAYLOR, United States District Judge.

OPINIONBY: GARY A. TAYLOR

OPINION:

JUDGMENT IN FAVOR OF THE UNITED STATES OF AMERICA

The parties' Cross-Motions For Summary Judgment came on for hearing before the Court, the Honorable Gary A. Taylor, United States District Judge, presiding. Noting that neither of the parties seek the Court's determination on Count Two of the Complaint for various reasons, the Court accordingly treats both motions as motions for summary adjudication. Based upon the parties' Joint Statement of Uncontroverted Facts and Exhibits, the Court's Order On Cross-Motions For Summary Adjudication, and good cause appearing therefor,

IT IS ORDERED AND ADJUDGED:

1. That, based upon the differing recoveries and the application of the failure to pay penalties resulting from the utilization of a NOL carryback from 1994 versus 1995, plaintiff's 1994 NOL carryback claim is not moot even though the IRS has conceded the 1995 NOL carryback claim;

2. That plaintiff is not entitled to the $ 1,049,657 in interest deductions claimed in this action for 1994 by virtue of the application of *26 U.S.C. Section 267*(a)(2), and hence, plaintiff did not incur a net operating loss of $ 810,267 for the year 1994;

3. That plaintiff is only entitled to $ 261,663.00 in interest deductions for 1994, and hence, plaintiff only incurred a net operating loss of $ 22,273 for the year 1994;

4. That the United States of America's cross-motion for summary adjudication of issues as to Count One of the Complaint is Granted;

5. That plaintiff's cross-motion for summary adjudication of issues as to Count One of the Complaint is Denied;

6. That, in light of the IRS's concession of the 1995 NOL carryback claim (Count Two of the Complaint) and the Court's granting of the government's motion for summary adjudication of the 1994 NOL carryback claim (Count One of the Complaint), there are no issues remaining before this Court;

7. That, pursuant to the IRS's concession of the 1995 NOL carryback claim (Count Two of the Complaint), plaintiff has an overpayment of $ 39,217.83 for its 1992 taxable year which is to be credited to the plaintiff pursuant to *26 U.S.C. Section 6402;* and,

8. This Judgment disposes of all issues in this complaint and action.

DATED: September 20, 2002

GARY A. TAYLOR

United States District Judge

Presented By:

DEBRA W. YANG
United States Attorney
EDWARD M. ROBBINS, JR.
Assistant United States Attorney Chief, Tax Division

SANDRA R. BROWN

Assistant United States Attorney

Attorneys for the United States of America

Approved as to content and form:

LAW OFFICES OF JAMES M. KAMMAN, APC

JAMES M. KAMMAN

Attorneys for Plaintiff
Ronald Moran Cadillac, Inc.

PROOF OF SERVICE BY MAIL

I am over the age of 18 and not a party to the within action. I am employed by the Office of the United States Attorney, Central District of California. My business address is 300 North Los Angeles Street, Suite 7211, Los Angeles, California 90012.

On August 30, 2002, I served the:

[PROPOSED] JUDGMENT IN FAVOR OF THE UNITED STATES OF AMERICA on each person or entity named below by enclosing a copy in an envelope addressed as shown below and placing the envelope for collection and mailing on the date and at the place shown below following our ordinary office practices. I am readily familiar with the practice of this office for collection and processing of correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service in a sealed envelope with postage fully prepaid.

Date of mailing: August 30, 2002

Place of mailing: Los Angeles, California.

See Attached Service List

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on: August 30, 2002, at Los Angeles, California.

Olivia Avila